No. 10,191

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

N. N. S. MATCOVICH,

Appellant,

vs.

RICHARD NICKELL, as Collector of Internal Revenue for the First District of California,

Appellee.

On Appeal from the District Court of the United States for the Northern District of California.

BRIEF FOR APPELLEE.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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BRIEF FOR APPELLEE.

OPINION BELOW.

The court below did not write an opinion nor enter any findings of fact or conclusions of law, but granted the Collector's motion to dismiss the bill of complaint and denied taxpayer's prayer for injunctive relief.

JURISDICTION.

This is an appeal from the order of the District Court dated June 22, 1942 (R. 11-12), granting the Collector's motion to dismiss taxpayer's bill of com-

plaint and denying him the relief prayed for. The complaint prayed for an injunction to restrain the collection of certain federal unemployment taxes. The jurisdiction of the District Court was apparently invoked under Section 24 of the Judicial Code, as amended. Appeal was thereupon taken from the District Court's order to this Court under date of July 3, 1942 (R. 13), under the provisions of Section 128(a) of the Judicial Code, as amended.

QUESTION PRESENTED.

Whether this suit to restrain the collection of taxes was prohibited by Section 3653 of the United States Internal Revenue Code.

STATUTE INVOLVED.

Internal Revenue Code:

> SEC. 3653. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.
>
> (a) *Tax.*—Except as provided in sections 272(a), 871(a) and 1012(a), no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.
>
> (b) *Liability of Transferee or Fiduciary.*—No suit shall be maintained in any court for the purpose of restraining the assessment or collection of (1) the amount of the liability, at law or in equity, of a transferee of property of a taxpayer

in respect of any income, war-profits, excess-profits, or estate tax, (2) the amount of the liability, at law or in equity, of a transferee of property of a donor in respect of any gift tax, or (3) the amount of the liability of a fiduciary under section 3467 of the Revised States (U. S. C., Title 31, §192) in respect of any such tax. (U. S. C. 1940 ed., Title 26, Sec. 3653.)

STATEMENT.

In the court below the bill of complaint substantially and briefly alleged as follows: During the years 1938, 1939 and 1940 taxpayer conducted a dance hall in the city of Sacramento, California, and licensed to dance therein certain ladies who were not his employees (R. 2-3), but who danced at his premises under a licensing agreement which provided that the licensee did not become an employee of the undersigned, but agreed to abide by all regulations established by him in the operation of his business (R. 4); that no other agreement of any kind was ever entered into between appellant and those ladies and that the tax assessments were based on appellee's erroneous holding that the dancing ladies were employees of appellant and that the relationship of independent contractors did not exist between the ladies and the taxpayer; that taxpayer did not come within the terms of the Federal Insurance Contributions Act or the Federal Unemployment Act, and that the taxes assessed thereunder were erroneous, unlawful and void (R. 3-5); that on or about May 19, 1942, taxpayer filed a claim for abate-

ment of these taxes and assessments, but that the abatement claim was denied and that the Collector was preparing to distrain and sell his property unless restrained and enjoined by the court (R. 5); that taxpayer had no plain, speedy, or adequate remedy at law for the reason that his action to determine the legality of the tax assessments may not be brought except upon payment of the tax and suit to recover it back, which he was unable to do and that therefore the payment of the taxes in the amount of $8,271.45 would work serious and irreparable damage to his property and business, which could not subsequently be remedied by the recovery of this tax by suit after payment; and that if the Collector seized and distrained upon the property of taxpayer, his entire business would have been lost and destroyed (R. 5-6); that, therefore, for the reasons stated, there was no tax due from taxpayer and therefore he did not pay any tax nor did he make any deductions from the moneys received by the ladies as required by the acts if the relationship of employer and employee existed because all of the ladies dancing in his premises entered into a license agreement prior to their dancing and that pursuant to such agreement the ladies who danced therein were licensees only and not employees (R. 6); and that taxpayer was informed and believed that no claim of any kind was ever filed by any of the ladies under and pursuant to the State Employment Act or Social Security Act until during the year 1939 when one of the ladies filed such an application for compensation under the State Employment Act based upon services alleged to have been

performed from October, 1938, to February, 1939, but that taxpayer resisted such application and that application was denied by the Adjustment Unit of the Division of Unemployment Insurance of the State of California on the ground that the employer and employee relationship did not exist; that thereupon the lady took an appeal from such decision and that the appellate body affirmed the ruling that the relationship of employer and employee did not exist between taxpayer and the lady; and that thereafter the California Employment Commission on January 13, 1939, filed an action in the Superior Court of California for the County of Sacramento against taxpayer for the purpose of recovering contributions under and pursuant to the Unemployment Act based upon the taxable wages alleged to have been determined by the dancing ladies during the years 1936, 1937, and the first quarter of 1938, on the theory that the relationship of employer and employee existed between taxpayer and the ladies; that thereafter the Honorable Peter J. Shields, before whom such action was tried on January 24, 1940, held that the California Employment Commission was not entitled to recover from taxpayer because the relation of employer and employee between taxpayer and the ladies did not exist. (R. 6-7.)

Whereupon, taxpayer prayed that judgment be entered against the Collector that there was no tax or assessment due under either of the acts as claimed by the Collector, and that the Collector, his deputies, agents and employees be enjoined and restrained from assessing, levying, or collecting any of the taxes, and

from doing any other thing designed to enforce or satisfy the tax or assessment thereof until such time that the court should have determined whether the taxes or assessment had been properly levied and assessed and for such further relief as may be just and proper under the circumstances, and for his costs. (R. 8.)

The court below issued an order to show cause to the Collector (R. 9), who thereupon, through the United States Attorney for the Northern District of California, interposed a motion to dismiss on the ground that Section 3653 of the United States Internal Revenue Code denies the court jurisdiction to entertain the bill of injunction, and that the complaint failed to show reasons why the provisions of this section should be disregarded. On the same date that such a motion was filed, the court heard arguments thereon and granted the Collector's motion to dismiss the bill of complaint and denied the relief prayed for therein.

SUMMARY OF ARGUMENT.

The prohibition of Section 3653, *supra,* is absolute and clearly denies the equity jurisdiction contended for here. The bill discloses that the dancing ladies were procured by taxpayer and signed an agreement with him to abide by all regulations established by him in the operation of his business. It is shown that the validity of the tax depends upon the resolution of a question of law and that the tax assessment is predicated upon an administrative determination made by

a duly constituted officer in the regular performance of his official duties. In such a situation the statute requires that the tax be paid before a resort can be had to the courts.

Moreover, there is no showing that equitable relief is necessary in this case to prevent great, immediate and irreparable injury to the taxpayer or his property.

The exceptional cases in which jurisdiction has been sustained despite the prohibition of the statute are not applicable here. In those cases it has appeared on the face of the bill that the imposition sought to be collected was a penalty instead of a tax or that there was no legal basis for the tax.

ARGUMENT.

THE PROPOSED ACTION OF THE ADMINISTRATIVE OFFICER HAS A PROPER BASIS AND IS NOT ARBITRARY. MOREOVER, THERE IS NO SHOWING THAT EQUITABLE RELIEF IS NECESSARY TO AVOID IRREPARABLE INJURY. IN THIS SITUATION THE DISTRICT COURT WAS WITHOUT JURISDICTION TO ENJOIN THE COLLECTION.

The provisions of Section 3653 of the Internal Revenue Code were first enacted into law in Section 10 of the Act of March 2, 1867, c. 169, 14 Stat. 471, 475, which was an amendment of the Internal Revenue Act of July 13, 1866, c. 184, 14 Stat. 98, 152. Such section was a part of the revenue act which set up a system of corrective justice to adjudicate tax controversies between the citizen and his Government. Such a system included, and still includes, protest and hearing on tax controversies prior to payment and then appeal

to the courts for final adjudication when the decisions of the administrative department are not agreeable to the taxpayer. The enactment of the law that no suit for the purpose of restraining the assessment or collection of any tax should be maintained in any court was an enactment into law of the long-established rule prevailing in the courts of this Country and in England. *Mooers v. Smedley,* 6 Johns. Ch. (N.Y.) 27 (1823). For seventy-five years this section of the law prohibiting injunctions restraining the collection of taxes has been held inviolate by the United States Supreme, appellate, and district courts.[1]

The bill of complaint shows on its face that taxpayer operated a dance hall and procured a number of ladies to dance with the male patrons of the hall; that the ladies signed an agreement to abide by all regulations established by taxpayer in the operation

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[1] *Graham v. duPont,* 262 U. S. 234; *Bailey v. George,* 259 U. S. 16; *Dodge v. Osborn,* 240 U. S. 118; *Snyder v. Marks,* 109 U. S. 189; *Cheatham v. United States,* 92 U. S. 85; *State Railroad Tax Cases,* 92 U. S. 575; *Gouge v. Hart,* 250 Fed. 802 (W.D. Va.); *Page v. Polk,* 281 Fed. 74 (C.C.A. 1st); *Seaman v. Bowers,* 297 Fed. 371 (C.C.A. 2d); *Cadwalader v. Sturgess,* 297 Fed. 73 (C.C. A. 3d); *Bashara v. Hopkins,* 295 Fed. 319 (C.C.A. 5th); *Sigman v. Reinecke,* 297 Fed. 1005 (C.C.A. 7th); *Hernandez v. M'Ghee,* 294 Fed. 460 (C.C.A. 8th); *Waldron v. Poe,* 1 F. 2d 932 (W.D. Wash.); *Union Fishermen's Co-op. Packing Co. v. Huntley,* 285 Fed. 671 (Ore.); *Witherbee v. Durey,* 296 Fed. 576 (N.D.N.Y.); *Reinecke v. Peacock,* 3 F. 2d 583 (C.C.A. 7th); *Corbus v. Alaska Treadwell Gold-Min. Co.,* 99 Fed. 334 (Alaska), affirmed, 187 U. S. 455; *Straus v. Abrast Realty Co.,* 200 Fed. 327 (E.D.N.Y.); *City of Seattle v. Poe,* 4 F. 2d 276 (W.D. Wash.); *Emaus Silk Co. v. McCaughn,* 6 F. 2d 660 (E.D. Pa.); *Joseph Garneau Co. v. Bowers,* 8 F. 2d 378 (S.D.N.Y.); *McDowell v. Heiner,* 9 F. 2d 120 (W.D.Pa.), affirmed, 15 F. 2d 1015 (C.C.A. 3d), certiorari denied, 273 U. S. 759; *Reinecke v. O. D. Jennings & Co.,* 16 F. 2d 927 (C.C.A. 4th); *Broadway Blending Corp. v. Sugden,* 2 F. Supp. 837 (W.D.N.Y.); *Nan v. Rasmusson,* 1 F. Supp. 446 (Mont.).

of his business; and that there is a controversy between the taxpayer and the Government with respect to whether or not the ladies are employees of the taxpayer. Thus it appears that the validity of the tax depends upon the resolution of a question of law and that the tax assessment is predicated upon an administrative determination made by a duly constituted officer in the regular performance of his duties. In such a situation, we submit that the jurisdiction of the courts to decide the controversy is postponed until after the tax is paid.

In *Snyder v. Marks,* 109 U. S. 189, 192-193, the statutory prohibition against injunction suits was construed to mean that the courts could not interfere with the Collector when he sought to collect "that which is in a condition to be collected as a tax, and is claimed by the proper public officers to be a tax, although on the other side it is alleged to have been erroneously or illegally assessed."

Accordingly, it is our position that a proceeding seeking to enjoin the collection of Federal taxes must stand or fall upon the sufficiency of the averments in the bill of complaint of the existence of such exceptional and extraordinary circumstances as will demonstrate that the proposed action of the administrative officers has no proper basis and is arbitrary. In addition, it must appear that, without equitable relief, the complainant will suffer great, immediate, and irreparable injury to its property.

In the few exceptional cases which have permitted injunctions it has appeared *on the face of the bill* that

the imposition sought to be collected was a penalty instead of a tax, or that the tax was not due. In addition there existed in conjunction therewith a combination of peculiar, unusual and extraordinary facts and circumstances which would deprive plaintiff of his property and make inadequate the results of a suit for the recovery of the taxes complained of. Thus, in *Miller v. Nut Margarine Co.,* 284 U. S. 498, the Court said (p. 510): "A valid oleomargarine tax could by no legal possibility have been assessed against respondent * * *." The Court further found that the combination of unusual facts and circumstances present there (none of which are even remotely akin to those alleged here) justified an exception to the restrictions of the statute and considered the merits of the case prior to payment. This is the leading exception to the prohibition of Section 3633. *Hill v. Wallace,* 259 U. S. 44, was a stockholder's suit and has been classed with the penalty cases. *Graham v. duPont,* 262 U. S. 234, 235, 237-238. The Court held that due to the nation-wide effect which would result from the collection of the tax and penalties and the multiplicity of suits involving each single trade in the grain market, the prohibition of the statute was inapplicable. In *Dodge v. Brady,* 240 U. S. 122, the court below considered the bill for injunction on the merits and dismissed it. When the appeal reached the Supreme Court, that Court held that while the trial court erred in assuming jurisdiction by reason of the provisions of the statute, it would be a waste of time to send the case back since the constitutional question involved had just been adversely decided against the taxpayer

by the Court at that term, and, hence, affirmed the dismissal below. In *Allen v. Regents,* 304 U. S. 590, jurisdiction was sustained because the threatened collection was not a tax but a penalty and the regents had no remedy at law to test the validity of the statute requiring them to collect taxes from the patrons of their athletic contests. In *Midwest Haulers v. Brady,* 128 F. 2d 496 (C. C. A. 6th), the court found that the taxes "probably are not in fact due" and that payment of the tax and a suit for the recovery thereof appeared plainly inadequate as such procedure would have resulted in the utter destruction of the taxpayer's business since it was unable to put up the money, and a sale of its assets (which were largely in the form of contracts, franchises, etc.) to pay its tax would have destroyed it. While we believe the case was erroneously decided, the findings mentioned distinguished it from the instant case.

In each decision which constituted an exception from the prohibition of the statute the peculiar, unusual and extraordinary facts and circumstances pleaded made it plainly appear that the remedy at law was not adequate and that if invoked the destruction or irreparable injury of taxpayer's business would have resulted. But here no such situation exists and this taxpayer has demonstrated in another suit for the recovery of social security taxes that the remedy at law is adequate. He was the plaintiff in *N. N. S. Matcovich v. Anglim* (N. D. Calif.), decided July 11, 1942, motion for rehearing pending, for the recovery of social security taxes for the year 1937, identical in

character with the taxes, the collection of which he seeks to restrain here. There, like here, he contended that the relationship between the ladies who danced at his hall and himself was that of independent contractors and not employee and employer. Thus, the question there in the suit for refund on its merits was identical with the question involving the merits here. The court, through Judge Martin I. Welsh, ruled against him on the merits in the refund suit and held that the relationship of employee and employer existed. This demonstration of a full and adequate remedy at law being available to taxpayer ought to end his case.

The prohibitions of the section involved apply to social security taxes. *Allen v. Shelton,* 96 F. 2d 102 (C.C.A. 5th), certiorari denied, 305 U.S. 630; *Beeland Wholesale Co. v. Davis,* 88 F. 2d 447 (C.C.A. 5th), certiorari denied, 300 U. S. 680; *Alpha Portland Cement Co. v. Davis,* 88 F. 2d 449, certiorari denied, 300 U.S. 681. Hardship on the taxpayer is not sufficient ground for enjoining the collection. *Concentrate Mfg. Corp. v. Higgins,* 90 F. 2d 439 (C.C.A. 2d), certiorari denied, 302 U.S. 714. Alleged avoidance of a multiplicity of suits was not a sufficient ground for restraining the collection of the tax in *Huston v. Iowa Soap Co.,* 85 F. 2d 439 (C.C.A. 6th), certiorari denied, 299 U.S. 594. In *Staley v. Hopkins,* 9 F. 2d 976 (N.D. Tex.), an injunction was denied to prevent seizure and sale by the Collector of plaintiff's homestead in satisfaction of a tax claimed to be due from his wife. A plea that plaintiff was without funds to pay the tax

demanded and that distraint would have destroyed his credit and business was not sufficient to warrant such jurisdiction in *Thornhill Wagon Co. v. Noel,* 17 F. 2d 407 (E.D. Va.). Mere inconvenience to taxpayer in the administration of a trust estate, usually a matter for equitable jurisdiction, did not void the prohibition in *Reinecke v. Peacock,* 3 F. 2d 583 (C.C.A. 7th). On the same day that the Supreme Court in *Child Labor Tax case,* 259 U.S. 20, held the child labor tax unconstitutional, it held in *Bailey v. George, supra,* that the prohibition of the statute forbade restraining the collection of such unconstitutional exaction.

Taxpayer here in his bill for injunction did not allege specificially and in detail facts and circumstances which, reasonably interpreted, might have constituted unusual and extraordinary facts and circumstances resulting in hardship and rendering the statutory remedy at law inadequate, but merely pleaded ultimate facts and conclusions of law. It is elementary that only material facts well pleaded are admitted in a motion to dismiss. Thus, none of the ultimate facts or conclusions of law alleged were admitted.

Taxpayer has a plain, adequate, and complete remedy at law by paying the taxes and then filing claims for refund and later instituting suit upon the rejection of the refund claim. His suit against a Collector in the California federal court, *supra,* for social security taxes paid by him for 1937 is undeniable proof and demonstration of the accuracy of this statement.

CONCLUSION.

In view of the foregoing, it is respectfully submitted that the order of the court below granting the Collector's motion to dismiss should be affirmed.

Dated, October 21, 1942.

Respectfully submitted,

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